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Supreme Court of the United States

OCTOBER TERM, 1948.

No. 442.

HANNAH COHEN, Executrix of the Estate of Sol Cohen, deceased, and DAVID F. COHEN, Intervenor,
Petitioners,

against

BENEFICIAL INDUSTRIAL LOAN CORPORATION,
Respondent,

and

O. W. CASPERSEN, JOHN BUDD SMITH, ROY E. TUCKER, EVERETT T. FELTER, JACKSON R. COLLINS, C. V. SMITH, E. L. KINCAID, ALBERT G. MORHART, RAYMOND D. SHEPARD, ALFRED G. ZIMMERMAN, FRED C. EIBELL, RICHARD K. STEINMAN and PAUL A. SEIBOLD, Individually,
Defendants.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI.

Opinions Below.

The opinion of the Court of Appeals (R. 40-61) is reported in 170 F. 2d 44. The opinion of the District Court (R. 29-38) is reported in 7 F. R. D. 352.

Jurisdiction.

The petitioners have invoked the jurisdiction of this Court under 28 U. S. C. §§ 1254(1) and 2101(c).

Statutes Involved.

Chapter 131 of the New Jersey Laws of 1945 (N. J. R. S. Cum. Supp. 14:3-15, 14:3-17) provides as follows:

> "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive.
>
> * * * * * *
>
> "This act * * * shall take effect immediately and shall apply to all such actions, suits or proceedings

now pending in which no final judgment has been entered, and to all future actions, suits and proceedings."

28 U. S. C. § 1652 provides as follows:

> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

Statement.

The decree of the Court of Appeals here sought to be reviewed decided a controversy between the respondent corporation and the petitioners, its stockholders, involving the enforcement by respondent against petitioners of its right to be reimbursed by the petitioners for certain expenses and counsel fees in a stockholders' derivative suit. The main action was instituted in the right of the respondent corporation on August 9, 1943 by Sol Cohen, as holder of 100 shares of the outstanding 2,000,000 shares of respondent's common stock, against certain directors and officers of the respondent corporation and others.

Issue has not yet been joined in such action. A summary of the proceedings in the main action which have taken place since the service of the original complaint follows:

On August 23, 1943 David F. Cohen, as holder of 150 shares of respondent's common stock, intervened as a party plaintiff. There then followed litigations in the District Court with respect to applications by the plaintiff for an extensive discovery and inspection. Thereafter the plaintiff and intervener conducted discoveries and inspections over a prolonged period of time. On February 14, 1946,

Hannah Cohen, the executrix of the Estate of Sol Cohen, deceased, was substituted in the place of Sol Cohen, deceased. Pursuant to an order of the District Court, dated February 14, 1946, an amended complaint was filed which, in addition to realleging the original four causes of action, contained five additional causes of action.

Thereafter, and on December 18, 1946, on motion by the individual defendants, alleged causes of action involving claims aggregating more than $90,000,000 were dismissed by the District Court for failure to state a claim upon which relief could be granted. *Cohen v. Beneficial Industrial Loan Corporation*, 69 F. Supp. 297 (D. N. J. 1946).

That the plaintiff and intervener would attempt to involve the Corporation in a $90,000,000 litigation as to which they could not even state a valid claim under the liberal rules of pleading in the federal courts is indicative of the need the respondent corporation has to be protected against the expenses to which it will be subjected if this action proves to be entirely lacking in merit.

On August 1, 1946 respondent made a motion for an order requiring petitioners to furnish security pursuant to Chapter 131 of the New Jersey Laws of 1945, thereby enabling the respondent to recover against the plaintiff and intervener the reasonable expenses to which it would be subject if the action proves to be unmeritorious. It was not disputed that all the statutory requirements were satisfied. The shares held by both petitioners never exceeded 0.0125% of respondent's capital stock and never had a total market value in excess of $8,062.50 (R. 13). Nor is there any dispute that respondent would be liable, in addition to the expense incurred directly by it in relation to the prosecution of the action, for the expenses, including the fees of

ounsel and accountants, incurred by its officers and direc-
ors in connection with a successful defense of the action.

Under the statute it was, therefore, mandatory upon
he District Court to require the petitioners to furnish
ecurity for the reasonable expenses to which respondent
ould be subjected. However, the District Court denied
espondent's motion on the ground that Chapter 131 of the
ew Jersey Laws of 1945 was procedural in nature and
ot binding on the federal District Court.

The Court of Appeals for the Third Circuit held that
1) the order of the District Court denying the motion was
eviewable by a direct appeal; (2) the statute in question
as binding on the federal court, under the doctrine of *Erie*
. R. v. *Tompkins*, 304 U. S. 64 (1938), *Guaranty Trust Co.*
. *York*, 326 U. S. 99 (1945), and *Angel* v. *Bullington*, 330
. S. 183 (1947), since the statute conferred a new substan-
al right on the corporation and since it embodied an impor-
ant public policy of the State of New Jersey, and (3) the
ontentions of the petitioners that the New Jersey statute
as unconstitutional were without merit.

Questions Presented.

(1) Whether the order of the District Court was review-
ble by direct appeal.

(2) Whether Chapter 131 of the New Jersey Laws of
945 is binding on the federal District Court (a) under the
octrine of *Erie R. R.* v. *Tompkins*, or (b) under Local Rule
of the District Court for the District of New Jersey.

(3) Whether Chapter 131 of the New Jersey Laws of
45 is constitutional.

Reasons for Denying the Writ.

1. The petition does not raise any question which warrants review by this Court. For twice within recent months, questions identical with those raised by the instant petition have been submitted to this Court, and twice this Court has refused to review them. These cases, both coming up from the Court of Appeals for the Second Circuit, are *Aspinook Corporation* v. *Bright*, 333 U. S. 846 (March 8, 1948), and *Donovan* v. *Queensboro Corporation*, 69 S. Ct. 45 (October 11, 1948). In the *Aspinook* case the District Court for the Southern District of New York had denied the motion of a corporation for security under a New York statute similar to the one here involved; and in the *Donovan* case the District Court for the Eastern District of New York had granted such a motion. In both cases, review of the decision of the Court of Appeals was sought by writ of certiorari, and in the alternative, direct review of the order of the District Court was sought by common law writ of mandamus or certiorari.

Further, there can be no reasonable doubt that the decision of the Court of Appeals for the Third Circuit here involved is correct for the following reasons: (a) The order of the District Court was reviewable by direct appeal because it finally and completely deprived the petitioner of a substantial right in a proceeding which was separate and distinct from the main action both as to parties and the subject matter; (b) Chapter 131 of the New Jersey Laws of 1945 is binding on the federal District Court whose jurisdiction was based solely on diversity of citizenship, because it creates a new substantial right in favor of a corporation and embodies an important public policy of the State of New Jersey; and (c) Chapter 131 is clearly con-

stitutional because there is no basis whatever for a judicial finding that the conditions which New Jersey attached to the prosecution of a derivative action in its courts, were arbitrary and unreasonable.

2. The only new factor, which was not presented in the *Aspinook* and *Donovan* cases, *supra,* is that the decision of the court below, in so far as it held that the order of the District Court was appealable, conflicts with an unreported decision of the Court of Appeals for the Second Circuit rendered in the *Aspinook* case, holding that such an order was not appealable. This conflict is limited to the one single question of appealability. We submit that this conflict does not involve an important question of federal law which should be reviewed by this Court. It is not a question of law which has general application, because it turns on the particular type of a state statute and there are only three states which have statutes similar to the subject statute and two of these are within the Third Circuit. Further, this Court has already indicated that it did not consider the question of appealability of sufficient importance to be reviewed by a writ of certiorari. *Donovan* v. *Queensboro Corporation,* 69 S. Ct. 45 (1948).

We shall now show that the decision of the court below was clearly correct.

ARGUMENT.

I.

The order of the District Court was appealable.

The petitioners argue that the order of the District Court was not a final order, and hence not appealable, because, in refusing to apply the statute, the order merely denied the respondent security for reimbursement for expenses and counsel fees, but did not bar the respondent's right to obtain such reimbursement upon the termination of the action. The petitioners' contention is clearly repudiated by the express provisions of the statute.

While the statute speaks in terms of "security", it actually creates a new liability on the part of the unsuccessful plaintiff to reimburse the corporation for resulting expenses, including counsel fees of individual defendants. The statute requires the furnishing of "security for the reasonable expenses * * * to which the corporation shall have recourse in such amount as the court * * * shall determine upon the termination of such action". Apart from this right of "recourse" to the so-called "security", the statute creates no right of reimbursement and no such right exists independently of the statute. Thus, by requiring the payment into court of a sum of money designated as "security", the statute creates the corporation's right to receive, and the plaintiff's obligation to give, reimbursement. Since the corporation's right is limited to recourse against the so-called "security", it follows that it will be impossible for the corporation to have any right of reimbursement unless security is given. As was said by the New York Court of Appeals with respect to a substantially identical statute, it "gives to corporations rights

which they had not previously enjoyed" (*Shielcrawt* v. *Moffett*, 294 N. Y. 180, 190, 61 N. E. (2d) 435, 440 (1945)).

Once the true nature of the new right created by Chapter 131 is analyzed, it is clear that the order of the District Court was a final appealable decision for the following reasons:

1. The order finally and completely disposes of a substantial right of the respondent corporation.

Under the statute, the corporation may require the posting of security "at any stage of the proceeding *before* final judgment". It is obvious, and not disputed here, that the statute refers to the final judgment of the trial court. See *Matter of Bailey*, 265 App. Div. 758, 761, 40 N. Y. S. (2d) 746, 749 (1st Dept. 1943), aff'd 291 N. Y. 534, 50 N. E. (2d) 653 (1943). Unless security is obtained before such final judgment, the corporation cannot obtain reimbursement from an unsuccessful plaintiff-stockholder. Thus, after the final judgment in the main action, the question of security and reimbursement for expenses would be moot and appellate review of the instant order would be meaningless, because even if the District Court's order denying security is reversed on appeal from the final judgment, the petitioners could no longer be required to give security, since the respondent's statutory right to security expires upon the entry of the final judgment. Unless permitted to appeal directly from the order of the District Court, the respondent thus would irretrievably lose the right conferred upon it by the New Jersey statute and suffer damage in excess of $100,000. As pointed out by Judge Frank in his concurring opinion in *Aspinook Corp.* v. *Bright*, 165 F. (2d) 294, 295 (C. C. A. 2d, 1947), in such case a corporation "will suffer an irreparable loss through an unreviewable erroneous order of the district court".

It is well settled that an order which, as here, would irreparably injure a party by depriving it of a substantial

right with absolute finality, is a final decision within the meaning of the jurisdictional statute.

Thus, in *Gumbel* v. *Pitkin*, 113 U. S. 545 (1885), an order denying a petition for intervention was held to be appealable, this Court saying (at p. 548):

> "The order dismissing Gumbel's intervention disposes of his rights, and is a final judgment as to that issue, as to which he has a right to a writ of error."

In *Ex parte Tiffany*, 252 U. S. 32 (1920), an order in a receivership suit was held to be final and appealable which denied an application of a state receiver to require the federal receiver to turn the property of the insolvent over to him. The Court said (at p. 36):

> "It is clear that the order made in the District Court refusing to turn over the property to the chancery receiver was a final decision * * * from which the chancery receiver had the right to appeal to the Circuit Court of Appeals. By the order the right of the state receiver to possess and administer the property of the corporation was finally denied."

In the instant case, the right of the respondent corporation to obtain reimbursement for counsel fees and expenses was finally denied by the District Court.

In *American Brake Shoe & Foundry Co.* v. *New York Rys.*, 282 Fed. 523 (C. C. A. 2d, 1922), app. dismissed *sub nom. Eighth Avenue R. R.* v. *Hedges*, 262 U. S. 736 (1923), an order made in a receivership suit was held appealable which denied the claims of certain creditors to immediate payment and deferred consideration of their claims until the final receivership accounting. Judge Rogers, speaking for the Court, said (at p. 527):

> "An adjudication is a final appealable order, if

> against a party in such a manner as leaves him no adequate relief, except by recourse to an appeal. * * * If the petitioners have a right of immediate payment, the orders must be regarded as a determination and denial of a substantial right, and which leave no adequate relief, except by recourse to an appeal. As such we have a right to review them."

2. The order determines a matter distinct from the general subject of litigation.

The applicable rule of law has been summarized as follows in 10 *Cyc. Fed. Procedure* (2d ed., 1943), p. 231:

> "The term 'final decision' as employed in the jurisdictional statute does not mean necessarily such decisions or decrees only which finally determine all the issues presented by the pleadings. While these are undoubtedly final decisions, the terms are not limited to them, but also apply to a final determination of a collateral matter distinct from the general subject of litigation, affecting only the parties to the particular controversy, and finally settling that controversy."

Of the many cases in which this Court has announced this well-established rule, it will suffice to refer by way of example to *United States* v. *River Rouge Improvement Co.*, 269 U. S. 411, 414 (1926), where this Court said:

> "While the general rule requires that a judgment of a federal court shall be final and complete before it may be reviewed on a writ of error or appeal, it is well settled that an adjudication final in its nature as to a matter distinct from the general subject of the litigation and affecting only the parties to the particular controversy, may be reviewed without awaiting the determination of the general litigation."

The instant order falls within this rule for two reasons: (1) Because of the alignment of the parties to the con-

troversy it determines, and (2) because of the subject matter of that controversy.

The fundamental difference between the instant controversy and the main action leaves no doubt as to its collateral nature. The main action is brought on behalf of the respondent corporation, which is merely a formal party thereto and has, therefore, submitted its rights to the protection of the court. In the instant controversy, on the other hand, the respondent seeks to enforce rights of its own against the petitioners, so that for the purpose of this proceeding its position with respect to them becomes truly adversary in character. Furthermore, the individual defendants, who are the real parties in interest in the main action, are not involved in the instant controversy and will be in no way affected by its disposition. The controversy thus clearly falls within the doctrine of the *River Rouge Improvement Co.* case, *supra*, as "a matter distinct from the general subject of the litigation and affecting only the parties to the particular controversy."

The same result follows from the nature of the right asserted in the instant controversy, namely a right to counsel fees and expenses. A controversy involving such a right has been held to be, without more, a collateral matter, having a distinct and independent character. In *Trustees v. Greenough*, 105 U. S. 527 (1881), this Court held an order awarding expenses and counsel fees to the plaintiff in a representative bondholder's suit to be appealable, saying (at p. 531):

> "The first question, however, is whether these orders do or do not amount to a final decree, upon which an appeal lies to this court. They are certainly a final determination of the particular matter arising upon the complainant's petition for allowances, and direct the payment of money out of the

fund in the hands of the receiver. Though incidental to the cause, the inquiry was a collateral one, having a distinct and independent character, and received a final decision."

In *Sprague* v. *Ticonic Bank*, 307 U. S. 161 (1939), the aintiff had petitioned the District Court for the allowance counsel fees and expenses, after the merits of the action d been finally decided by this Court. The District Court ld that it had no authority to grant the petition on the ound that it had no further function to perform other an to carry out the mandate of the Supreme Court. he Circuit Court of Appeals affirmed for the reasons ated by the District Court, and for the further reason at the term of court at which the decree was entered d long since passed. This Court reversed on the ground at under the doctrine of *Trustees* v. *Greenough, supra*, e issue of an allowance of counsel fees was separate d distinct from the main litigation and was, therefore, t covered by either the original decree or the appellate andates. As to the requirements of terms of court, the ourt said (at p. 170):

> "Since we view the petition for reimbursement as an independent proceeding supplemental to the original proceeding and not a request for a modification of the original decree; the suggestion of the Circuit Court of Appeals—that it came after the end of the term at which the main decree was entered and therefore too late—falls."

The grounds on which the petitioners seek to distinish *Trustees* v. *Greenough* and *Sprague* v. *Ticonic Bank*, *upra*, are clearly untenable. The *Greenough* case is sought be distinguished because the order there involved an ward of expenses and counsel fees, and not security there-

for. But, as has been shown *supra*, this attempt to differentiate between the right to security and the right to reimbursement for expenses and counsel fees rests upon a complete misunderstanding of the meaning and effect of Chapter 131. Under the New Jersey statute, it is the posting of the security which creates the respondent's right to reimbursement. Thus, the respondent's motion under Chapter 131 was an assertion of its right of reimbursement for counsel fees and expenses and as such was of the same nature as the application in the *Greenough* case. That case is further sought to be distinguished because it granted the motion, whereas here the motion was denied by the District Court. However, that factor is entirely immaterial. If the proceedings instituted by the respondent's motion were collateral and separate and distinct from the main litigation, any determination of such collateral proceeding is a final appealable decision. Reference is made in this connection to *Gelberg* v. *Richardson*, 82 F. (2d) 314 (C. C. A. 9th, 1936), where an order *denying* an application for counsel fees was held to be a final appealable decision. The petitioners' analogy to summary judgment is clearly inapplicable, for a motion for summary judgment does not relate to a matter distinct from the issues of the litigation, but on the contrary seeks a determination of those very issues.

The petitioners seek to distinguish the *Sprague* case on the ground that there the motion for expenses and counsel fees was made after a determination for the merits. But the court below relied on the *Sprague* case merely for the proposition that an issue respecting the allowances of counsel fees and expenses is separate and distinct from the main litigation. This Court clearly so held in the *Sprague* case. It follows that the instant order, which determined such an issue, was a final appealable decision.

II.

Chapter 131 of the New Jersey Laws of 1945 is binding on a Federal District Court sitting in New Jersey.

The decision of the court below that the statute in question was binding on the federal court is clearly correct because of the following three reasons:

1. The statute conferred upon corporations a substantial right within the meaning of *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945); and under that case it is immaterial whether the statute can be classified as "procedural" for some purposes. As shown above, the statute created a new right in favor of corporations against stockholders prosecuting derivative actions. There can be no doubt that this new right is a substantial one. The expense of defending a derivative action, including accountants' and attorneys' fees, may be very substantial and is certain to be so in a case involving complicated transactions of a large corporation. For example, in *Donovan* v. *Queensboro Corp.*, 75 F. Supp. 131 (E. D. N. Y. 1947), the court fixed the amount of the initial security to be given at $50,000. The right created by the statute in question is designed to protect the corporation and 95% of its stockholders from being subjected to a substantial loss by a minority stockholder unsuccessfully pursuing a remedy which is supposed to be for the benefit of the corporation.

That such right is a substantial one, follows *a fortiori* from *Sioux County* v. *National Surety Co.*, 276 U. S. 238 (1928), where it was held that a state created right to counsel fees must be enforced by the federal courts. For in the instant case, the right covers all expenses, including

accountants' and attorneys' fees, whereas in the *Sioux County* case the expenses were limited to *attorneys'* fees incident to the prosecution of action on insurance contracts.

2. The statute in question represents an important public policy of the State of New Jersey, designed to cope with an evil which the Legislature found to exist. Under *Angel* v. *Bullington*, 330 U. S. 183 (1947), such public policy of the State may not be thwarted by recourse to the federal court.

3. Even if Chapter 131 did not create a substantial right and did not embody an important public policy of the State, it would still have to be enforced under the District Court's Local Rule 15, which provides as follows:

> "*Applicability of State Court Procedure.* In circumstances not provided for by the Federal Rules of Civil Procedure, or by these rules, the procedure and practice of the Courts of the State of New Jersey shall govern."

It is well settled that rules of court, unless directory and merely for the protection of the court, have the force of law and a federal court has no power to suspend or modify retroactively any rule which it has made. *Rio Grande Irrigation and Colonization Co.* v. *Gildersleeve*, 174 U. S. 603 (1899); *Weil* v. *Neary*, 278 U. S. 160 (1929).

The petitioners' arguments to the contrary are invalid.

In the first place, petitioners argue that the order of the District Court was merely concerned with the "procedural" matter of furnishing security and had nothing to do with any right of the respondent to be reimbursed for expenses. As shown above, this argument is completely fallacious. For under the statute, the denial of "security"

at the same time denies any right to reimbursement for the expenses in question. The petitioners misconceive the nature of the statute when they assert that the posting of security and the creation of the right of reimbursement are "two distinct questions". The right to reimbursement is limited to, and created by, the security which is posted.

In the second place, the petitioners' argument that Rule 23 of the Federal Rules of Civil Procedure prevents the application of the New Jersey statute is entirely devoid of merit. Rule 23 is entirely different from Chapter 131. It does not give a corporation any right whatever to obtain reimbursement for expenses to which it may be subjected as a result of an unmeritorious derivative action. Rule 23 does not deal with that subject at all. Chapter 131 is thus in no way inconsistent with Rule 23. Carried to its logical conclusion, the petitioners' position would lead to the absurd result that all state law relating to derivative stockholders' suits has been superseded by Rule 23 in the federal courts.

III.

Chapter 131 of the New Jersey Laws of 1945 is constitutional.

It is significant that in attacking the constitutionality of Chapter 131 under Point III of their brief, the petitioners have made no serious attempt to show that the statute affects any property rights of stockholders and fail to take issue with the statement in the opinion of the court below (R. 59) that:

> "The right to bring a stockholder's derivative suit is not a property right and as this court held in *Overfield* v. *Pennroad Corporation*, 146 F. 2d 889,

> 894. * * * the individual stockholder is permitted to sue 'simply to set in motion the judicial machinery of the court.'"

In the recent case of *Myer* v. *Myer*, 271 App. Div. 465, 473, 66 N. Y. S. (2d) 83, 91 (1st Dept. 1946), aff'd 296 N. Y. 979, 73 N. E. (2d) 562 (1947), the rule is stated as follows:

> "A stockholder has no right to institute action in his own behalf, but only on behalf of the corporation.
>
> * * * * * *
>
> "The right that the plaintiffs have * * * to sue in the name of and for the benefit of the corporation * * *, is a contingent right of action only. Insofar as it may be of benefit to the stockholder personally the property right is a remote and insubstantial one * * *. Under these circumstances we do not deem the right is one that may demand protection against legislative regulation * * * The situation might be different if the stockholder had a right of personal recovery against the officers and directors and was prevented from pursuing his remedies as a creditor as to some accrued claim. * * *
>
> "*Here the corporation was the creditor and its rights remained unabridged.*" (Italics ours.)

Since the prosecution of a derivative action does not involve a property right of the stockholder, it is impossible for the New Jersey statute, regulating the prosecution of such an action, to impair any property right of the petitioners; and for that reason alone, their attack on the constitutionality of Chapter 131 must fail. We shall, however, briefly show that even if the petitioners' property rights were involved, the arguments ar unsound.

1. Chapter 131 does not violate the due process or equal protection clause of the Constitution.

(a) With the exception of a decision of this Court (*Gulf, C. & S. R. R.* v. *Ellis*, 165 U. S. 150 (1897)) which on its facts has no bearing on the question here involved, the only authorities relied on by petitioners in support of their argument that the statute violates the equal protection clauses are two law review articles. Opposed to their contention is a long line of cases upholding the legislation here involved, culminating in the decision of the New York Court of Appeals in *Lapchak* v. *Baker*, 298 N. Y. 89, 80 N. E. (2d) 751 (1948). It is, of course, well settled that a statute may be struck down as violative of the equal protection clause only if the classification has no rational basis whatever. Where the reasonableness of the statute is debatable at all, it must be upheld. *Zahn* v. *Board of Public Works*, 274 U. S. 325 (1927). Here, the Legislature found that a grave evil existed in the abuse of derivative suits, which inflicted severe financial losses on corporations. Surely, it was rational for the Legislature to recognize a distinction between plaintiffs who have and who do not have a substantial interest in the effect of the litigation on the welfare of the corporation, and accordingly to establish a classification on the basis of a minimum interest in the corporation. Such classification has been widely adopted in the general law of corporations in fixing the rights of stockholders. The fact that groundless suits may possibly also be brought by some not included in the class and not subject to Chapter 131 does not make the statute arbitrary and unreasonable. It is well settled that the Constitution merely requires that a classification rest on some rational basis; it does not require that it be free from all possible imperfections and it permits the Legislature

of the State to exercise its own judgment as to the line to be drawn. *Missouri, K. & T. Ry.* v. *Cade*, 233 U. S. 642 (1914); *West Coast Hotel Co.* v. *Parrish*, 300 U. S. 379 (1937).

(b) As to the due process clause, petitioners do not cite any authorities in support of their position. Again, the applicable case law is all the other way. Moreover, it is clear that the remedy selected by the Legislature for the evil found by it to exist was reasonable. The statute does not prohibit the prosecution of a derivative action by any stockholder, but merely subjects it to a reasonable condition. The power of the Legislature to subject the prosecutions of actions to conditions precedent cannot be questioned. *Jones* v. *Union Guano Co.*, 264 U. S. 171 (1924). This Court has, moreover, consistently held that it is reasonable and constitutional to condition the prosecution or defense of a cause of action on the assumption of liability for the adversary's reasonable counsel fees. *Life & Casualty Co.* v. *McCray*, 291 U. S. 566 (1934); *Dohany* v. *Rogers*, 281 U. S. 362 (1930); *Sioux County* v. *National Surety Co.*, 276 U. S. 238 (1928); *Missouri, K. & T. Ry.* v. *Cade*, 233 U. S. 642 (1914). Nor is it unreasonable to condition the prosecution of an action on the posting of security. Indeed, in *Gant* v. *Oklahoma City*, 289 U. S. 98 (1933), this Court held that the enjoyment and use of one's own property may be conditioned on putting up security. The Court there upheld the constitutionality of a city ordinance which provided that no oil well should be drilled within the city limits until there should be filed with the city clerk a bond in the sum of $200,000 covering each well. *A fortiori*, it must be permissible to subject the prosecution of a derivative stockholder's action to such a condition, where the stockholder does not assert his own property rights, but merely acts

as an instigator for the protection of the corporation's property rights, and where loss and damage will be inflicted on the corporation if the action is unsuccessful.

2. Chapter 131 does not violate the full faith and credit clause.

The question of full faith and credit was not raised by the petitioners in the court below. In any event, their argument that the full faith and credit clause prevents the application of the statute to a Delaware corporation has no merit.

It is clear that no question arises under the full faith and credit clause, where the application of the local law is justified by established principles of conflict of laws. In this case, Chapter 131 is expressly made applicable to foreign corporations. There can be no doubt that New Jersey had a sufficient governmental interest to make the statute so applicable. Chapter 131 merely regulates the conditions on which causes of action may be prosecuted in the New Jersey courts, and hence merely imposes conditions on the performance of acts in New Jersey. Thus, New Jersey has the superior, if not the sole, governmental interest in the matter.

That the statute here in issue is of the type which the local forum may apply under settled rules of conflict of laws, was held in *Shieleraut* v. *Moffett*, 184 Misc. 1074, 56 N. Y. S. (2d) 134 (Sup. Ct., N. Y. Co., 1945), where the court said (184 Misc. at p. 1077, 56 N. Y. S. (2d) at p. 136):

> "* * * it seems to me that a major concern is whether section 61-b is procedural in the sense that it is the type of statute which our courts may apply conveniently, practically and properly to foreign corporations doing business in this state to the end that our procedure shall maintain a desirable measure of uniformity in derivative stockholders' suits.

> I believe that section 61-b, and it must therefore follow, its New Jersey counterpart, are procedural in that sense."

It is, of course, perfectly consistent to hold a statute to be "procedural" for conflict of laws purposes, while at the same time holding it to be binding on a federal court as embodying an important public policy and creating a substantial right. An example is *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945), holding a state statute of limitations to be "substantive" for the purpose of the doctrine of *Erie R. R.* v. *Tompkins*, although it is concededly "procedural" for conflict of laws purposes.

3. "Retroactive" application of Chapter 131 does not violate the Constitution.

The constitutionality of the application of the statute to stockholders who acquired their shares prior to its enactment has been squarely upheld by the New York Court of Appeals in *Myer* v. *Myer, supra,* 296 N. Y. 979, 73 N. E. (2d) 562 (1947), aff'g 271 App. Div. 465, 66 N. Y. S. (2d) 83 (1st Dept. 1946). If the statute is properly applicable to plaintiffs who became stockholders prior to its enactment, it is immaterial whether or not suit was pending at that time. The nature of the right involved is exactly the same before and after a complaint is filed. Thus, the highest court of the State of New Jersey has expressly held that statutes creating a right to counsel fees may constitutionally be applied to pending actions. *Igoe Bros.* v. *National Surety Co.*, 112 N. J. L. 243, 169 Atl. 841 (1934). Hence, the petitioners' contentions that such application would violate the due process and contracts clauses of the Constitution are without merit. With re-

spect to the contracts clause argument on page 22 of petitioners' brief, it should be pointed out that both *Coombes* v. *Getz* and *Hathorn* v. *Calef*, on which petitioners rely, do not relate to the relationship between stockholder and corporation, but between creditor and corporate debtor. These cases have thus no bearing on the question here involved. On the other hand, it has been expressly held that the right to bring a derivative action is not a contract right. *Myer* v. *Myer*, *supra*.

Conclusion.

The petition for certiorari should be denied.

Respectfully submitted,

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